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IN THE

Supreme Court of the United States

OCTOBER TERM, 1958

No. 685

EZRA ROYCE, *Petitioner*,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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Petitioner prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Ninth Circuit.

OPINIONS BELOW

The opinion of the Tax Court (R. 263-278) is not officially reported. The opinion of the Court of Appeals (Appendix A, *infra*, pp. 1a-13a) is not yet officially reported.

JURISDICTION

The judgment of the Court of Appeals was entered on November 10, 1958. (Appendix B, *infra*, p. 13a.) The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254.

QUESTIONS PRESENTED

The following questions are presented:[1]

(1) Where a wife concededly owns a capital interest in a partnership and regularly contributes services to it, may her share of the firm earnings nevertheless be taxed to her husband on the ground that she is not a partner for income tax purposes.

(2) Where a wife concededly owns a capital interest in a partnership, to which neither she nor her husband contributes services, may her share of the firm earnings nevertheless be taxed to her husband on the ground that she is not a partner for income tax purposes.

STATUTES INVOLVED

Internal Revenue Code of 1939:

SEC. 181. PARTNERSHIP NOT TAXABLE.

Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity.

SEC. 182. TAX OF PARTNERS.

In computing the net income of each partner, he shall include, whether or not distribution is made to him—

* * * * *

[1] The opinion below dealt with a number of other issues which are not involved here.

(c) His distributive share of the ordinary net income or the ordinary net loss of the partnership .... (26 U.S.C. 1952 ed., Secs. 181, 182.)

STATEMENT

This petition involves two partnerships—one doing business in Portland, Oregon, and the other in Seattle, Washington. The facts relating to each may be summarized as follows:

Portland Partnership

In 1942 the petitioner was a stockholder in Yellow Cab Incorporated, an Oregon corporation doing business in Portland, Oregon. (R. 263, 641.) On July 31, 1942, he transferred slightly less than half of his stock to his wife Dora F. Royce. (R. 641.) The following day the corporation was dissolved, and the stockholders formed a partnership to operate the business as Yellow Cab Company. (R. 263-266, 641.)

The partnership was organized under written articles executed by all the prior stockholders, including Dora. Under the terms of the agreement the partners assumed the liabilities of the corporation. The partnership was to "continue for the duration of the joint lives of the parties," unless otherwise dissolved by them. Its stated capital consisted of the assets formerly owned by the corporation plus undistributed income. Profits and losses were to be shared by the partners in proportion to their relative interests. Each partner had "an equal voice in the control of the business and operation of the partnership." The partnership was required "to keep accurate books of account," which were to be open to all the partners. Upon dissolution of the firm the surplus was to be divided among them according to their interests. (R. 263-266.)

Dora and the petitioner were married in 1923. (R. 387.) She was a woman of substantial business experience. Before marriage she had been a millinery designer and held positions of responsibility. Her business background included the executive supervision of employees, as well as control of overhead and other expenses. (R. 447-448, 527-528.)

During the taxable years Dora and the petitioner were the only working partners. (R. 272, 518, 641-642.) As managing partner, the petitioner made the day-to-day decisions in the operation of the business. (R. 641.) Since he had numerous other activities, he only spent about half of his time there. (R. 641.)

Dora regularly rendered services to the partnership as a checker. She checked the conduct of the drivers, the appearance of their uniforms, the condition of the cabs, and the number of passengers carried. She performed these services at hotels, stands, depots and other places where cabs regularly picked up or discharged passengers. Her observations were recorded in reports which she filed at the office. (R. 641.) The hours devoted by Dora to her checking varied. Often she would work all day. On other occasions she would work less. At times she did her checking in the evening. She was experienced in her work because she had performed the same services for the prior corporation. (R. 641-642.) Now and then the petitioner did some checking. (R. 642.) In the absence of Dora's services the partnership would have had to employ a checker to do her work. (R. 642.) Dora also attended conferences of the partners and expressed her views. (R 642.) Whenever there was a distribution of profits, Dora received her share. (R. 430, 454.) All distributions to her were in the form of checks payable to her.

(R. 273.) She maintained a separate checking account at The First National Bank of Portland. (R. 273-274, 431, 535.) She never had a joint checking account with the petitioner. (R. 449, 455, 536.)

The drawing accounts of Dora and the petitioner on the books of the partnership show the following withdrawals during the taxable years 1944 through 1947 (R. 272):

Year	Dora	Ezra
1944	$ 48,777.75	$ 58,184.94
1945	69,180.00	80,820.00
1946	48,865.01	57,086.99
1947	4,612.00	5,388.00
Total	$171,434.76	$201,479.93

Dora exercised her own judgment in spending or investing her funds. (R. 466-467, 535-536, 552-553.) She spent about $1,850 for two fur coats, $8,000 for two Chrysler automobiles, $350 for an exercycle, $1,800 for silverware, and $400 for lace cloth. In addition, she bought a Plymouth and Cadillac, purchased various furnishings for the home, acquired several hundred dollars worth of books, and spent about $18,000 in improvements of the house. (R. 275, 431-433, 467, 531-533.) The petitioner provided for ordinary household expenses, such as food, light, heat, groceries, insurance, and taxes. (R. 433-434, 533.)

Dora invested $7,000 in Government bonds and $2,500 in Missouri-Pacific stock. (R. 275, 433, 456.) These securities were acquired in her own name. (R. 455-456.) She loaned about $70,000 to the petitioner for investment in Alder Gold-Copper Company. (R. 275, 456-463, 542, 552.) The petitioner was interested in

the promotion of that corporation, and in 1949 he acquired about 5 percent of its common stock. (R. 214-215, 457-458, 460-463, 484, 489, 551-552.) Dora also had stock in the corporation. (R. 457-458.)

The Commissioner determined that Dora was not "a bona fide partner" in the Portland partnership, and taxed her share of the partnership profits for the years 1944-1947 to the petitioner. The Tax Court sustained the Commissioner's adjustments and the resulting deficiencies. (R. 275-278.) The Court of Appeals affirmed the conclusion of the Tax Court. (R. 641-642.)

Seattle Partnership

Yellow Cab Company of Seattle was a Washington corporation. (R. 642.) Its stockholders were the petitioner and six other individuals. (R. 266.) On April 20, 1944, the petitioner transferred a portion of his shares to Dora. (R. 642.) He duly filed a gift tax return and paid a gift tax. (R. 267.)

On May 1, 1944, the corporation was liquidated and dissolved. (R. 642.) On the same day a partnership was formed to carry on the business previously conducted by the corporation. (R. 266-271, 642.) The firm consisted of ten members. (R. 642.) The interest of the petitioner was about 5 percent, and the interest of Dora about 7 percent. (R. 642.) Under the Articles of Copartnership the initial term of the partnership was five years. It was to continue for similar successive periods unless any partner gave notice to the contrary. Its capital consisted of the assets of the dissolved corporation, subject to its liabilities, which the partners assumed. (R. 267-269.)

Neither the petitioner nor Dora was active in the business. (R. 642.) Another partner was in direct

charge of the enterprise and performed all the duties of management. (R. 642.)

Dora received her proportionate share of firm distributions together with the other partners. (R. 439-440, 465-466, 619.) All distributions to her were made by checks payable to her. (R. 465, 618-619.) For the years 1945 through 1949 the withdrawals of Dora and the petitioner from the Seattle partnership were as follows (R. 272-273):

Year	Dora	Ezra
1945	$41,622.53	$30,994.97
1946	19,662.53	14,644.97
1947	12,342.53	9,194.97
1948	12,342.53	9,194.97
1949	5,022.53	3,744.97
Total	$90,992.65	$67,774.85

At the time of trial the partnership had suffered losses for two years. Dora's account was charged with her share of the losses. (R. 621.)

The Commissioner determined that Dora was not "a bona fide partner" in the Seattle partnership, and taxed her share of the partnership profits for the years 1945-1947 to the petitioner. The Tax Court sustained the Commissioner's adjustments and the resulting deficiencies. (R. 275-278.) The Court of Appeals affirmed the conclusion of the Tax Court. (R. 642-643.)

REASONS FOR GRANTING THE WRIT

The Court of Appeals has held that Dora's share of the profits of each partnership was taxable to the petitioner on the ground that she did not qualify as a partner for income tax purposes. The applicable stat-

utes are sections 181 and 182 of the Internal Revenue Code of 1939. Section 181 states, "Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity." Section 182 provides that each partner shall report his distributive share of the income or losses of the partnership. This Court has authoritatively construed these statutes in *Commissioner* v. *Culbertson*, 337 U. S. 733 (1949).

The *Culbertson* case articulates four basic rules. First, the concept of partnership in income tax law is precisely the same as the concept of partnership in commercial law. "A partnership is, in other words, an organization for the production of income to which each partner contributes one or both of the ingredients of income—capital or services." 337 U. S. at 740. The question is "one concerning the bona fide intent of the parties to join together as partners;" and a party reflects the requisite intent by contributing either services or capital. *Id.* at 743, 748. Or, as Mr. Justice Frankfurter stated in his concurring opinion, so-called family partnerships are not to be disregarded "as partnerships for income-tax purposes even though they be genuine commercial partnerships." The term "partnership" in sections 181 and 182 does not have "a content peculiar to the Internal Revenue Code." The customary criteria which determine the existence of a partnership also "apply in tax cases when the Government challenges the existence of a partnership for tax purposes." "In plain English, if an arrangement among men is not an arrangement which puts them all in the same business boat, then they cannot get into the same boat merely to seek the benefits of §§ 181 and 182. But if they are in the same business boat, although they may have varying rewards and

varied responsibilities, they do not cease to be in it when the tax collector appears." *Id.* at 750-752, 754.

Second, if a partner contributes services to the enterprise, the question is not whether the services "are of sufficient importance to meet some objective standard," but whether the services indicate an intention to join the enterprise. *Id.* at 742. Third, regardless of services the donee of an intra-family gift can "become a partner through investment of the capital in the family partnership." *Id.* at 745. "Original capital" is not "an essential test of membership in a family partnership." *Id.* at 748. Whether the donee has made an investment of gift-capital depends on whether the gift is a true transfer of a participating interest or "mere camouflage." *Id.* at 746-747. Fourth, if partners have "agreed that the services or capital to be contributed presently by each is of such value to the partnership that the contributor should participate in the distribution of profits, that is sufficient." There is "room for an honest difference of opinion as to whether the services or capital furnished by the alleged partner are of sufficient importance to justify his inclusion in the partnership." A court cannot "substitute its judgment for that of the parties." *Id.* at 744-745.

In the light of these controlling criteria the decision below is in direct conflict with *Commissioner* v. *Culbertson, supra,* and decisions of other Courts of Appeals. By the same token, it presents important questions in the administration of the income tax law which should be resolved by this Court.

1. Under the *Culbertson* decision Dora clearly qualified as a member of the Portland partnership because

of the services she continually contributed. The Tax Court agreed that Dora's services were similar to those normally performed by a regular employee. (R. 272.) However, it then tried to dismiss her services by characterizing them as "relatively inconsequential." (R. 277.) In other words, it sought to evaluate Dora's services in response to "some" elusive "objective standard" of its own—the very sort of approach which this Court unmistakably condemned in *Commissioner* v. *Culbertson, supra,* at 742. On appeal the petitioner argued, on the basis of the evidence, that the Tax Court's disparaging description was clearly erroneous as well as legally irrelevant. The Court of Appeals accepted the petitioner's view of the evidence. In the precise words of that Court,

> "Dora Royce regularly acted for the partnership as a checker. She checked the conduct of the drivers, the appearance of their uniforms, the condition of the cabs and the number of passengers carried. She checked at hotels, stands, depots and other places where cabs regularly picked up or discharged passengers. Her observations were recorded in reports which she filed at the office. The hours devoted by Dora to her checking varied. Often she would work all day. On other occasions she would work less. At times she did checking in the evening. She was experienced in her work because she had performed the same services for the prior corporation. Now and then E. Royce did some checking. In the absence of Dora's services, the partnership would have had to employ a checker to do the checking. Dora also attended conferences of the partners and expressed her views." (Appendix A, *infra,* p. 11a.)

These detailed facts, as succinctly summarized by the Court of Appeals, speak very clearly for themselves.

Dora was a working partner actively engaged "in the affairs of the business." 337 U. S. at 747. Indeed, apart from the petitioner, Dora was the only other working partner. In the absence of her services, the firm would have had to employ someone else to perform her duties. The essence of the matter is that husband and wife were working together in accordance with their respective abilities.

Despite its plain-spoken findings the Court of Appeals nevertheless refused to recognize the services of Dora. It did so on the strange ground that her services "were such that any wife who had the interests of her husband's business at heart might perform." (Appendix A, *infra*, p. 11a.) We need not labor the point that serving steadily as a checker of drivers and cabs is scarcely the routine concern of "any wife" in her husband's business. In taxing Dora's income to the petitioner the Court of Appeals clearly departed from the controlling principles of the *Culbertson* opinion.

2. Under the *Culbertson* decision Dora equally qualified as a member of the Portland partnership because of her undisputed capital interest. As the Tax Court found, the petitioner gave Dora a capital interest in the business through a transfer of stock, and she then executed the articles of partnership along with the other members of the firm. (R. 263-266.) Or, as the Court of Appeals stated the facts, the petitioner "transferred to her 14,000 shares, slightly less than half of the stock he owned" in the corporation. After the corporation was dissolved, "a partnership was organized where each partner kept the same percentage of ownership as had been represented by stock in the former corporation." (Appendix A, *infra*, p. 10a.)

Dora's interest in the partnership was no less real than her interest in the corporation. Under the partnership agreement she "had the same legal rights and liabilities as did the other partners with respect to the firm." *Whayne* v. *Glenn*, 222 F. 2d 549, 551 (6th Cir. 1955). The petitioner did not retain any special powers or privileges which rendered her interest illusory. Along with the other partners she had "an equal voice" in the business while the partnership continued, and along with them she was to receive her aliquot share of the surplus when it dissolved. (R. 265.) Whenever distributions were made, she took her portion. See pp. 4-5 *supra*. Dora's interest was as genuine as the petitioner's interest. As the Court of Appeals put it, "by law she had a one-half interest in the proceeds." (Appendix A, *infra*, p. 11a.)

The Courts of Appeals and the Court of Claims have repeatedly held, in strict adherence to the *Culbertson* decision, that a donee of a capital interest in a partnership must be recognized as a partner, regardless of any services which he may or may not perform. See *Lamb* v. *Smith*, 183 F. 2d 938 (3d Cir. 1950); *Ginsburg* v. *Arnold*, 185 F. 2d 913 (5th Cir. 1950); *Seabrook* v. *Commissioner*, 196 F. 2d 322 (5th Cir. 1952); *Heusler* v. *Whitson*, 200 F. 2d 538 (6th Cir. 1952); *Marcus* v. *Commissioner*, 201 F. 2d 850 (5th Cir. 1953); *Nicholas* v. *Davis*, 204 F. 2d 200 (10th Cir. 1953); *Scofield* v. *Mauritz*, 206 F. 2d 135 (5th Cir. 1953); *Estate of Horsey* v. *Commissioner*, 214 F. 2d 294 (5th Cir. 1954); *Scofield* v. *Davant*, 218 F. 2d 486 (5th Cir. 1955); *Fly* v. *Cole*, 219 F. 2d 653 (5th Cir. 1955); *Whayne* v. *Glenn*, *supra*; *Williamson* v. *United States*, 152 F. Supp. 716 (Ct. Cls. 1957).

Though Dora concededly had a capital interest in the firm and "a one-half interest in the proceeds," the Court of Appeals nevertheless refused to respect her as a partner. It attempted to justify its adverse conclusion on the ground that she spent various sums for "family purposes" and made a loan to the petitioner. (Appendix A, *infra*, p. 11a.) In this connection, the evidence discloses, first, that the petitioner continued to pay the ordinary expenses of the household; and, second, that a number of years after Dora acquired her interest in the Portland partnership, she loaned the petitioner $70,000 for investment in a mining corporation.[2] See pp. 5-6, *supra*. Undoubtedly, if the question to be resolved is whether a wife has acquired an interest in a business, the use of the income produced by the interest may be relevant evidence in settling the dispute. But here there is no such dispute on the factual level. The Court of Appeals has specifically held that Dora acquired an interest in the corporation; that she retained "the same percentage of ownership as had been represented by stock in the former corporation;" and that "by law she had a one-half interest in the proceeds." (Appendix A, *infra*, pp. 10a-11a.) Hence Dora's expenditures are immaterial, for they derived from her own choice as owner. Surely a wife does not cease to be a partner because she makes a loan to her husband or buys things for the home. Cf. *Wilson* v. *Commissioner*, 161 F. 2d 661 (7th Cir. 1947); *Lamb* v. *Smith*, *supra*; *Estate of Dorsey* v. *Commissioner*, *supra*. The Commissioner's complaint can only begin and end with the question whether Dora

[2] The corporation was organized in January, 1947. (Ex. 45-SSSS.)

truly owned a capital interest in the partnership. And that question has been resolved against him.

In short, the Court of Appeals has determined that Dora owned a capital interest in the partnership and an interest in the proceeds of the partnership. Its failure to treat her as a partner conflicts with *Commissioner* v. *Culbertson*, *supra*, and the many decisions which conform to it. See p. 12, *supra*.

3. The same conflict exists in regard to the Seattle partnership. Indeed, the conflict is more obvious here, since none of the earnings derived from the petitioner's services. As the Court of Appeals stated the relevant facts, "The firm consisted of ten members." Dora "acquired a capital interest" in the enterprise "through a gift" by the petitioner. Dora's interest was about 7 percent and the petitioner's about 5 percent. Neither the petitioner nor Dora "was active in the business. Another partner was in direct charge of the enterprise and performed all the duties of management." (Appendix A, *infra*, pp. 11a-12a.) Both the petitioner and Dora were simply passive investors in a business whose income stemmed from the capital plus the efforts of others. The income of the firm was no more attributable to the petitioner than to Dora. In these and similar circumstances, where the income is wholly divorced from any services by the donor-partner, the courts until now have consistently concluded that he cannot be taxed on the profits of the donee-partner. See *Jones* v. *Baker*, 189 F. 2d 842 (10th Cir. 1951); *United States* v. *Atkins*, 191 F. 2d 146 (5th Cir. 1951); *T. W. Rosborough*, 8 T.C. 136 (1947); *Arthur A. Byerlein*, 13 T.C. 1085 (1949);

William Collins, Sr., 7 T.C.M. 830 (1948); *Estate of A. C. Hewitt, Sr.*, 9 T.C.M. 383 (1950); *R. G. Bock*, 9 T.C.M. 709 (1950); *Edna Jurgensen*, 9 T.C.M. 1027 (1950); *Juliana Schroeder*, 11 T.C.M. 8 (1952).

If Dora had held an equivalent interest in a corporate enterprise, her ownership would clearly be recognized for tax purposes. Her ownership was no less genuine because the business was carried on through a partnership. A gift of a corporate interest and a gift of a partnership interest are subject to the same rules. *Williamson* v. *United States*, 152 F. Supp. 716 (Ct. Cls. 1957). In the words of Judge Madden, who has concisely summarized the *Culbertson* decision as it affects donee-partners, "One may avoid paying taxes on the future income from his property by the drastic remedy of giving away his property." The gift "may be to anyone at all," and "may be of land, stocks, bonds, or any other kind of property. It may be of a corporate interest or of an undivided interest. The only question pertinent in an income tax case is whether he really gave the property away, or only pretended to give it away in order to escape or reduce the taxes on the income." The same settled principle applies to "shares in partnership as well as to other kinds of property, and even if the partnerships are family partnerships." *Id.* at 719.

In the present case there is no question of pretense or sham. The Court of Appeals has found that Dora acquired a capital interest in the business, and that she was a member of the firm. Hence it plainly erred in concluding that Dora's share of the income was taxable to the petitioner.

4. The Court of Appeals has held here that a partner may be ignored for tax purposes even though he or

she regularly contributes services or owns a capital interest. This decision necessarily raises significant questions, for it seriously unsettles the law relating to so-called family partnerships.

In 1951 Congress enacted special provisions on such partnerships. Revenue Act of 1951, § 340, amending § 3797(a)(2) and adding § 191 of the 1939 Code.[3] These provisions are solely concerned with a partnership interest "created by gift." For present purposes they state that an individual "shall be recognized as a partner for income tax purposes if he owns a capital interest in a partnership in which capital is a material income-producing factor, whether or not such interest was derived by purchase or gift from any other person." The legislation of 1951 does not in any way diminish or curtail the significance of the questions involved here. First, it does not in the least affect the status of those who otherwise qualify as partners by contributing personal services. Second, it merely reiterates the pre-existing law in regard to those who qualify through a gift of a capital interest. If the decision below is correct, then it equally applies to the legislation of 1951. See H. R. Rep. No. 586, 82d Cong., 1st Sess. 32, 33 (1951); Sen. Rep. No. 781, 82d Cong., 1st Sess. 38, 39 (1951); *Alexander* v. *Commissioner*, 194 F. 2d 921, 923-924 (5th Cir. 1952); *Toor* v. *Westover*, 200 F. 2d 713, 716 (9th Cir. 1952); *Parker* v. *Westover*, 221 F. 2d 603, 607 (9th Cir. 1955). Hence the questions posed by the decision below radiate continuing problems which require the thoughtful consideration of this Court.

[3] The provisions have been continued in Int. Rev. Code of 1954, § 704(e)(1).

5. There is no question of fact to be unravelled here. With respect to the Portland partnership the Court of Appeals has found that Dora regularly contributed services and owned a capital interest. With respect to the Seattle partnership the Court of Appeals has found that Dora owned a capital interest and that none of the firm's earnings was attributable to services of the petitioner. (Appendix A, *infra*, pp. 10a-12a.) And so the two questions presented here are sharply defined issues of law which are unembarrassed by any difference over evidentiary details. They derive from the Court of Appeals' failure to apply the appropriate criteria of judgment as carefully enunciated in *Commissioner* v. *Culbertson, supra*. If those criteria are not faithfully followed, the *Culbertson* opinion becomes a meaningless essay, and the governing principles of law disappear into a morass of disparate adjudications. A just system of taxation presupposes the existence of intelligible rules of law which are uniformly applied.

Unless the criteria of the *Culbertson* opinion are to be ignored, Dora was clearly a member of both partnerships. She and the other partners were "in the same business boat." She did "not cease to be in it" because the Commissioner appeared on the scene. 337 U. S. at 754.

CONCLUSION

For the foregoing reasons the petition for a writ of certiorari should be granted.

Respectfully submitted,

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